United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

75-7344 75-7344

IN THE

UNITED STATES COURT OF APPEALS

For the Second Circuit

No. 75-7344

ETHEL BECKERMAN and ABRAHAM BECKERMAN, on behalf of themselves and all other participants in Times Square Associates, similarly situated,

Plaintiffs-Appellants,

-against-

IRA JAY SANDS and F.S. MANAGEMENT CORP.,

Defendants-Appellees.

On Appeal From a Judgment in the United States District Court For the Southern District of New York

BRIEF FOR PLAINTIFFS-APPELLANTS

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PRELIMINARY STATEMENT

This is an appeal from a judgment in the United States District Court for the Southern District of New York entered on March 31, 1975 dismissing the amended complaint (Rec. #30).* A memorandum and order made by Judge Morris E. Lasker on March 20, 1975 explains his reasons for dismissal to be that the Court lacks jurisdiction in that (a) the claims of the plaintiffs and class members could not be aggregated for jurisdictional purposes and (b) the amount in controversy as to the plaintiffs and each member

*Reference is to the document so numbered in the Record on Appeal.

of the class was less than the $10,000 jurisdictional minimum. (A-92)**

ISSUES PRESENTED

1. May the claims of the plaintiffs and the class members be aggregated in order that the amount in controversy be in excess of the $10,000 jurisdictional minimum?

2. Do the amended complaint and the additional facts adduced on the various motions disclose that the amount in controversy exceeds $10,000 with respect to the plaintiffs and each member of the class?

3. Was the Court below correct in dismissing the amended complaint on account of an apparent absence of the jurisdictional amount in controversy after (a) a defendants' motion to dismiss the original complaint on that basis had been denied almost two years earlier and twice again thereafter, (b) plaintiffs had been granted an interlocutory summary judgment on the issue of liability but no hearing or discovery had been had on the issue of damages, (c) the amended complaint was thereafter served pursuant to a direction by the Court, and (d) the amended complaint did not change the nature of the right being asserted?

4. Is Times Square Associates such an entity or body that a person having an equitable interest therein may maintain a derivative action in its right?

STATEMENT OF THE CASE

A. Nature of the Case and Prior Proceedings.

This is a diversity class action brought in

**References are to pages in the Joint Appendix

July, 1972 on behalf of approximately 150 investors in a New York real estate syndicate known as Times Square Associates ("Associates"). It is brought against Ira Jay Sands ("Sands") as the managing partner and trustee of Associates[(1)] on account of various breaches of fiduciary duty in managing the business and affairs of Associates and against F. S. Management Corp. ("F.S. Management"), a corporation controlled by Sands and members of his family, on account of its having participated with Sands in those breaches of duty. In addition, plaintiffs originally brought this action as a derivative action in the right of Associates (A-4 to A-10). Before filing their answer, the defendants moved under F.R.C.P. 12 to dismiss the action on the ground that the Court lacks jurisdiction by reason of the absence of the $10,000 jurisdictional amount in controversy. (Rec. #6). Plaintiffs made a cross-motion F.R.C.P. 23(c)(1) for a determination that the action is to be maintained as a class action and under F.R.C.P. 66 for the appointment of a receiver of the

(1) Plaintiffs contend that Associates is both a partnership and a trust. If it be either, then two courses follow. First, it is an entity in whose right a derivative action may be maintained. Second, the claims of the plaintiffs and the class members are joint or in common so that this is a true class action in which aggregation of claims is permitted for jurisdictional purposes.

Plaintiffs contend, alternatively, that if Associates is not a partnership or a trust then the plaintiffs and the class members are the equitable owners, as tenants in common, of the long term net lease standing in the name of Associates as merely nominal owner.

These contentions will be discussed subsequently herein.

assets of Associates. By order dated November 15, 1973 Judge Lasker denied the defendants' motion to dismiss the individual claims on behalf of the class members, granted the defendants' motion to dismiss the derivative claims, granted plaintiffs' motion that the action is to be maintained as a class action and denied plaintiffs' motion for the appointment of a receiver. (Rec. #19). In denying the motion to dismiss the individual claims, Judge Lasker said in his memorandum (A-31) that the amount in controversy requirement was met as to plaintiffs and each member of the class by reason of their claims for punitive damages. He held, however, that aggregation of their claims was not permissible and that the derivative claim must be dismissed since Associates is not an entity in whose right a derivative action may be brought.

Subsequently, after the defendants filed their answer (Rec. #21), plaintiffs moved under F.R.C.P. 56(c) for an interlocutory summary judgment on the issue of liability alone (Rec. #28). Defendants thereupon made a cross-motion for summary judgment and renewed their earlier motion to dismiss for lack of jurisdiction (Rec. #30). By memorandum and order dated June 28, 1974, Judge Lasker granted plaintiffs an interlocutory summary judgment and denied defendants' motion to dismiss (A-46). Defendants made a motion for reargument on the same grounds as previously asserted (Rec. #37) which Judge Lasker again denied on November 20, 1974 (A-68). However, in this order Judge Lasker referred the matter to Magistrate Schreiber to hear and report

on the issue of damages. He also directed the plaintiffs to file an amended complaint eliminating the derivative claim and setting forth factual allegations appropriate to a suit for punitive damages (A-75).

Pursuant to that order, plaintiffs filed the amended complaint (A-77 to A-90). Defendants again moved to dismiss for lack of jurisdiction (Rec. #51) which was this time granted on March 20, 1975 (A-92). The judgment of dismissal without costs was entered on March 31, 1975 (Rec. #60) and this appeal followed.

B. Facts.

The plaintiffs and approximately 150 class members are passive investors in Associates which is a New York real estate syndicate organized in 1961. Sands is presently the sole managing partner and trustee and is the person who actually supervisors the management of Associates' property and makes all the decisions with respect to the property and the affairs of Associates. The following recitation of fact sets forth the background and relationship between the parties and is quoted from Judge Lasker's Memorandum granting plaintiffs' motion for an interlocutory summary judgment (at pages A-49 to A-53).

"The factual background is undisputed. Associates is a New York real estate syndicate organized in 1961 to acquire the long term net lease to a commercial structure

in New York City, and to derive income from the operation of the building. At the time Associates acquired the building in 1961, it was comprised of three general partners: Sands, Jerome Wishner and George Gewanter. The partners sold participations to the public by means of a prospectus, reserving to themselves certain assets and interests in the building as a promotor's fee.

"The prospectus stated:

> 'The property will be completely operated at actual cost by Tri-Management Company, a New York Partnership, consisting of Ira Sands, Jerome Wishner and George Gewanter under a management contract...[with Associates]... The said management contract is non-assignable and is on an at will basis, and may be cancelled at the option of either Associates or Tri-Management Company, with no liability enuring (sic) to either party.'

The management contract between Tri-Management and Associates, dated May 1, 1961, provided that, effective as of the date of Associates' acquisition of the leasehold, Tri-Management (a partnership composed of the same three general partners as Associates) would (1) collect rents (2) rent vacant space (3) supervise employees (4) operate and maintain the building and (5) negotiate and prepare all necessary leases. The contract was non-assignable and terminable at will be either party. Finally, it provided, 'There will be no fee or charge to [Associates]

whatsoever for the aforesaid services.' In short, both the prospectus and the management contract indicate that Associates' general partners promised that for so long as they managed the building (as principals of Tri-Management) they would do so without compensation.

"The legal relations of the parties were embodied in one other document, the participation agreement. Each investor signed such an agreement with one of the three general partners of Associates (each of whom originally owned a one-third interest in Associates) at the time of his purchase of a participation. By the agreement, each investor designated the partner from whom he had bought his participation his 'agent' for purposes of administering his investment. The duties of the 'agent' were specified, in relevant part, as follows. To:

> '(a) Collect rental income for the benefit of and distribute the same to the Participants, and shall not incur obligations or make decisions except in strict conformity with this agreement...
>
> (b) Distribute to each Participant herein proportionate distributions...
>
> (c) Engage attorneys and accountants to keep accounts and records, and annually submit detailed reports to all Participants.
>
> ***
>
> (l) shall receive no compensation, whatsoever, for acting in the capacity as Agent herein.'

The Agreement also specified certain limitations on the power of the Agent to sell, mortgage or transfer any partnership asset and provided that in the event of resignation or other disability of any of Sands, Wishner or Gewanter, 'the remaining agents shall continue to act under this agreement.' If all three resigned, their successors were to be designated by 80% of the participants. Finally, the Agreement contained a merger clause stating that the Agreement constituted the entire understanding among the parties, and an acknowledgement of receipt of the Prospectus by the participant.

"By virtue of the Participation Agreement and the management contract, Sands, Wishner and Gewanter occupied two roles vis-a-vis investors in Associates. By the Participation Agreement they assumed the rule of administrative officers of Associates as a profit-making real estate syndicate. As partners of Tri-Management, they obligated themselves to Associates, as a business entity, to conduct the physical operation and management of the building. In effect, therefore, Associates subcontracted the job of managing agent of the building to Tri-Management.

"In accordance with its management contract with Associates, Tri-Management managed the building until the end of 1962. At that time, the First Republic Corporation of America, principally owned and controlled

by Sands, Wishner and Gewanter, took over management of the building, charging Associates a management fee of 1% of gross income. This arrangement continued until about May, 1966 when Sands, Wishner and Gewanter ended their business association. Wishner and Gewanter then left both the management of Associates and First Republic. First Republic ceased to manage the building, but pursuant to the terms of the Participation Agreement detailed earlier, Sands remained at Associates as sole general partner.

"As of July 1, 1966, Sands took over management of the building and, on behalf of Associates, made demand on First Republic for the management fees it had received from Associates. The 1967 financial report of Associates notes these charges as a receivable to Associates: 'The sum of $5,772 due from the First Republic Corporation of America, represents the excess of receipts over disbursements, during their term of management, which was discontinued July 1, 1966.' (Exhibit '1968' annexed to SKLAVER affidavit).

"On August 10, 1966, Sands sent a letter to all investors, which stated:

> 'I am continuing as sole General Partner of Times Square Associates, without fee or salary to me as such General Partner in accordance with the terms of the original Participation Agreement.'

The August 10 letter also stated that because First Republic refused to continue the management of the building, 'it is

now necessary that Times Square handle its own administrative requirements and distributions to the Investors.'

"Sands, acting as general partner of Associates, managed the building himself until February, 1967, when he organized F. S. Management Company, wholly owned by himself and members of his family. The annual financial statements of Associates for the years 1967-1972 reflect substantial annual charges for 'management fees,' 'administrative charges,' and 'leasing commissions' paid to F.S. Management by Associates. These facts are undisputed."

***

What Sands did in the management of the business is spelled out in greater detail in the moving papers on the summary judgment motion and forms the basis of the charges against him. Judge Lasker did not discuss those details in his memorandum, presumably because they relate to the issue of damages. The Record discloses that between 1967 and 1972 Associates paid F. S. Management a total of $125,340 for management fees and administration charges and that it paid $27,342 in leasing commissions, although the portion of the latter amount which was paid to F. S. Management is not presently known. In addition, Sands and F. S. Management used office space in the building for their own purposes without the payment of rent to Associates and also subleased some of that space for their own benefit. Finally, Associates paid legal fees to Sands and his lawfirm;

Sands received forwarding fees from other lawyers who were handling Associates' legal matters; and he also received a substantial legal fee for representing another party in a transaction in which Associates was a party (A-62 to A-65; Rec. #28, pp. 5-6 of Rule 9(g) Statement, pp. 6-12 of affidavit of Harvey M. Sklaver).

With respect to the allegations relating to punitive damages, these are set forth in the fifth cause of action in the amended complaint (A-84 to A-89). It is first alleged that Sands' breaches of duty were done knowingly and wilfully. It is next alleged that in May and June, 1970, plaintiff, Ethel Beckerman, called for a meeting of the investors in Associates to discuss its affairs and how they might go about attaining meaningful information about its affairs from Sands; that meeting, held on June 23, 1970, was attended by numerous investors who elected a so-called Investors Committee, of which Mrs. Beckerman was a member, to make an inquiry into the affairs of Associates and to report to the investors; the following day Sands instituted an action against Mr. and Mrs. Beckerman in the New York Supreme Court seeking damages of one and a quarter million dollars on account of allegedly defamatory statements which they allegedly made at the meeting, the alleged defamatory statement being that Sands is "Mafia controlled", the he is "illegitimate, a bastard" and that he "cheated the investors" (A-86);

Sands knew those allegations to be false since he had an agent as well as a stenotype reporter at the investors' meeting; and that Sands brought the Supreme Court action for the sole purpose of frightening and intimidating the plaintiffs into discontinuing their efforts to inquire into the manner in which he was conducting the affairs of Associates. It is further alleged that Sands started a separate $600,000 action against another member of the Investors Committee, Mrs. Gussie Manheim, for the same purpose.

Thus, the gravamen of the claim for punitive damages is that, in addition to knowingly and wilfully diverting funds belonging to Associates, Sands sought to hide his defalcations by intimidating the Beckermans and Mrs. Manheim by specious lawsuits and perjury therein.

ARGUMENT

Preliminarily, it should be noted that this Court must consider orders made by Judge Lasker with respect to both the original and the amended complaint as all interlocutory orders are within the scope of this appeal (Allied Air Freight, Inc. v. Pan American World Airways, Inc. 393 F.2d 441, 444, 2nd Cir. 1968). Thus, a brief comparison of the two complaints may assist the Court.

The original complaint was both a class action for an accounting by the investors in Associates and was

also a derivative action in the right of Associates. The ad damnum paragraph prayed for (a) an accounting, (b) the appointment of a receiver and (c) such other and further relief as may be just and proper. After Judge Lasker's first order dismissing the derivative claim (Rec. #19) and his direction that the plaintiffs file an amended complaint seeking damages (A-75), which in essence is the end product of an accounting action, this was done. The ad damnum paragraph in the amended complaint prays for compensatory damages (sub-paras. "a" and "d") and punitive damages (sub-par. "e"). It also prays for the impression of a trust on the amounts received by F. S. Management which can be traced into other assets and investments (in accordance with New York law, Holmes v. Gilman, 138 N.Y. 369 [1893]). The amended complaint also prays that Sands pay to the investors their collective share of the entire value of the properties of Associates (alleged to be $1,156,000) since a breach of duty by a fiduciary entitles the cestuis to terminate the relationship between them (Jewett v. Commonwealth Bond Corp. 241 App. Div. 131 [1934])(sub-par. "b"). This has the same effect as asking for the appointment of a receiver in the original complaint. Finally, it prays for such other and further relief as may be just and proper. Significantly, a plaintiff is not bound by his prayer for relief and is entitled to such relief as the facts justify

(F.R.C.P. 54(c); Kahan v. Rosenstiel, 424 F.2d 161, 174, 3rd Cir. 1970; United States etc. v. Maryland Cas. Co., 384 F.2d 303, 394, 2nd Cir. 1967)..

Since the two complaints seek the same ultimate relief (except for the derivative claim which is merely an intermediate step before distribution by Associates to the investors) the following POINTS will not be specifically addressed to one or the other of the complaints.

POINT I

THE CLAIMS OF THE PLAINTIFFS AND THE CLASS MEMBERS MAY BE AGGREGATED IN ORDER TO REACH THE $10,000 JURISDICTIONAL MINIMUM AMOUNT IN CONTROVERSY

The first question for determination is whether the claims of the plaintiffs and the class members can be aggregated in order to reach the $10,000 jurisdictional minimum amount. If this answer is in the affirmative, then we need go no further as the judgment must be reversed on that basis alone.

A. Analysis of the rules regarding aggregation.

At the outset, it should be noted that the doctrine of aggregation of claims is not based upon the class action or other procedural rules. It is based upon the Supreme Court's interpretation of the phrase "matter in controversy" (Snyder v. Harris, 394 U.S. 332 at 336 [1969]).

In that case, the Supreme Court said at page 335:

> "***Under old Rule 23, class actions were divided into three categories which came to be known as 'true', 'hybrid' and 'spurious'. True class actions were those in which the rights of the different class members were common and undivided; in such cases aggregation was permitted. Spurious class actions, on the other hand, were in essence merely a form of permissive joinder in which parties with separate and distinct claims were allowed to litigate those claims in a single suit simply because the different claims involved common questions of law or fact. In such cases aggregation was not permitted; each plaintiff had to show that his individual claim exceeded the jurisdictional amount.***"

To state the aggregation of claims doctrine is simple; to apply it in specific cases is what has caused difficulties. One commentator (2) has suggested that the Courts evolved two tests to determine whether aggregation should be allowed in class actions. The first is the "interest in distribution test", which sought to determine whether the party opposing the class had any interest in the manner in which the recovery was to be distributed to the members of the class. If it did not concern him. the claims were deemed common and undivided. Illustrative of the cases applying this test are those in which some sort of fund is involved. This test was invoked in Miller v. National City Bank of New York 147 F.2d 798, 2nd Cir. 1945) in which this Court said:

(2) Note, Aggregation of Claims in Class Actions, 68 Columbia Law Review, 1554 (1968).

"...What the plaintiff is seeking here is to compel guaranty to restore to a fund which belonged to all the certificate holders in common monies it is said to have misapplied and then to make a distribution as ancillary to the primary relief." (id. pp. 799-800).

Miller was a class action brought by a holder of a certificate of participation in a grant of credit by a syndicate of banks to the Imperial Russian Government. His complaint alleged that one of the banks participating in the syndicate had failed to distribute to the certificate holders an unexpended credit of $15,000,000, but rather had retained the sum for its own purposes. This Court permitted aggregation.(3)

Another case which permitted aggregation on the basis of this first test was Dierks v. Thompson (414 Fed.2d 453, 1st Cir. 1969). There, former employees of a subsidiary of a corporation brought a class action to determine their rights under a profit-sharing pension plan. Similarly, in Dixon v. Northwestern National Bank of Minneapolis (276 F.Supp. 96, D.C.Minn. 1967) eight persons sued the trustee of an employees' profit-sharing trust, claiming improper use of trust funds. Finally, in Berman v.

(3) Subsequent to that decision the plaintiff amended the complaint to allege what appeared to be common law fraud. A motion to dismiss the amended complaint was successful. Aggregation could not then be permitted because now the claims were several in that each member of the class had to prove the specific representations which were made to him and his reliance thereof (Miller v. National City Bank of New York 166 F.2d 723, 728, 2nd Cir. 1948.) That amendment changed the nature of the right asserted (Grady v. Irvine, 254 F.2d 224 4th Cir. 1950).

Narragansett Racing Association (414 F.2d 311, 1st Cir. 1969; cert. den. 396 U.S. 1037) purse winners sued race track owners to establish their rights to a percentage of the track "breakage".(4) The Court held that the amount in controversy was the entire percentage of breakage claimed on behalf of all the purse owners and not merely the plaintiff's share therein.

There is a second test which the courts have applied to determine whether aggregation should be permitted. That is the "essential party" test, which holds that claims are aggregable when none of the class members could bring suit separately without directly affecting the rights of the other members of the class. A recent case which applied this second test was Brandt v. Owens-Illinois, Inc. (62 F.R.D. 160, S.D.N.Y. 1974). In Brandt, it was contended that the defendant's Amended Articles of Incorporation required it to employ a purchase fund of $2,000,000 per year to repurchase its 4% cumulative preferred shares in the open market at the best prices obtainable but not in excess of $100 per share. It was alleged that the defendant's failure to meet that requirement was a breach of its obligations to its preferred

(4) Pari-mutuel winnings are usually paid in full ten cent amounts. "Breakage" is the fractional amount in excess of full ten cent amounts and is retained by the track. Thus, if a pari-mutuel calculation is $4.83, the track pays $4.80 to the bettor and retains the $.03 breakage. Sometimes payoffs are in full nickel amounts or full twenty cent amounts but the breakage is still the odd cents excess over the payoff amount.

shareholders. In that case, Judge Bauman said at page 169:

> "...Under the latter test, the instant case would surely qualify as a 'true' class action, for once it is determined whether or not the defendant has been in compliance with its amended Articles of Incorporation, all preferred shareholders will be affected similarly."

One more case should be noted. Bass v. Rockefeller (331 F.Sup. 945, S.D.N.Y. 1971) was a class action by a welfare recipient for an injunction restraining implementation of a New York statute reducing both the number of persons eligible for Medicaid and benefits and services provided to such persons without prior approval of the Secretary of the Department of Health, Education and Welfare. Neither the plaintiff nor any member of the class had a claim in excess of $10,000. Judge Tenney held that aggregation of claims was permitted under both of the aforementioned tests. As to the first, he held that the fund was the entire amount of Medicaid payments which would be made by the State out of federally financed funds to all members of the class. As to the second test, he held that it was met since a decision on the validity of the statute would affect the rights of all members of the class.

B. <u>This is a true class action; the claims are joint or common</u>.

As stated earlier, two tests have been suggested to determine whether aggregation should be allowed. Applying the interest in distribution test to the instant case we find

that the defendants are being called upon to restore monies which they diverted and in which all of the plaintiffs and class members have an identical interest, except as to amounts. The fact that each of the investors signed a separate Participation Agreement with one of the three original managing partners (Sands, Wishner or Gewanter) is not significant since all of those Participation Agreements were identical and were pursuant to a single transaction for the sale of all the participating interests. The agreement designated each managing partner as Nominee for them all and for Associates (A-11, third Whereas clause) and provided that all counterparts were to be taken together as a single instrument (A-15, par. 13). In any event, by reason of paragraph 4 of the Participation Agreement, when Wishner and Gewanter resigned as general partners of Associates and Sands remained as the sole managing partner he stepped into the shoes of Wishner and Gewanter so that there was a merger of the three sub-classes of investors into a single class of which Sands was the managing partner (A-13, par. (h)). Indeed, on August 10, 1966 Sands sent a letter to all the investors in which he stated:

> "I am continuing as sole General Partner of Times Square Associates, without fee or salary to me as such General Partner in accordance with the terms of the original Participation Agreement." (A-53; Rec. #28, Exhibit 3).

Applying the essential party test we find that the instant case would certainly be a true class action for

two reasons: (a) once it has been determined that Sands breached his fiduciary duty and the extent thereof, all the investors will be affected similarly, and (b) if the Court grants the equitable relief of appointing a receiver or dissolving Associates, the other investors will, ipso facto, be affected. Also, Judge Tenney, in the Bass case, spoke of a "fund" and we have that here as well. The fund is the total monies diverted by Sands and the assets into which those funds can be traced.

1. Associates is both a partnership and a trust.

a. Judge Lasker recognized that if Associates is a partnership the claims may be aggregated. In his Memorandum on the defendants' first motion to dismiss the original complaint under F.R.C.P. 12, he referred to the partnership question as the "central issue" (A-53). Defendants apparently recognized this also because they argued at length that Associates is not a partnership (Rec. #13, pp. 10-16) but is a joint venture (id. pp. 13-14). In accepting their argument, Judge Lasker, aside from anything else, overlooked the rule that a joint venture is a form of partnership for a limited undertaking. In Hardin v. Robinson (178 App.Div. 724, 729 [1916], aff'd. 223 N.Y. 651), the Court said:

> "...A joint adventure is subject to exactly the same rules as a technical partnership. (Spier v. Hyde, 92 App.Div. 467, 472; King v. Barnes, 109 N.Y. 267, 285.)..."

In King v. Barnes (1888), the Court of Appeals said:

> "We consider these objections to be untenable, and some of them too frivolous to merit consideration. A sufficient consideration is afforded to it [the Agreement] by the mutual promises of the respective parties to contribute equally to the capital required to carry out the contemplated enterprise, and their agreement to share equally in the profits and advantages expected to accrue therefrom. It is entirely immaterial whether this agreement constituted a partnership in a technical, legal sense, or whether it was a joint enterprise to be conducted by the parties for their mutual benefit. So far as their rights and liabilities are concerned in this case, the result is the same, and rests upon the express terms of the agreement, and they are now to be enforced upon the principles applying to partnership transactions. [Citations]"

See also Napoli v. Domnitch (34 Misc. 2d 237, 240 [1962], modified on other grounds, 18 A.D.2d 707, aff'd. 14 N.Y. 2d 508). While it makes no difference whether Associates is a true partnership or merely a joint venture, the evidence discloses that it is the former. During the course of his Memorandum granting plaintiffs' motion for interlocutory summary judgment, Judge Tasker recognized that Associates is a partnership. He said:

> "Sands [after Wishner and Gewanter had retired], acting as general partner of Associates, managed the building himself until February, 1967..." (A-53).
>
> * * *
>
> "...As sole managing partner of Associates after 1966, he [Sands] was the only person charged with, and duly empowered to, administer the syndicate..." (A-57).

* * *

"As sole general partner of Associates Sands was clearly under a duty of disclosure before engaging in any self-dealing, whether or not in good faith..." (A-59).

* * *

"The partnership agreement does not explicitly cover the situation in which Associates sues as plaintiff; it provides only for indemnity of the Agent against liability incurred in his official capacity..." (A-64).

Also, on numerous occasions after Wishner and Gewanter had retired Sands referred to himself as a partner and to Associates as a partnership. On August 10, 1966 he sent a letter to all the investors in which he said:

"I am continuing as sole General Partner of Times Square Associates, without fee or salary to me as such General Partner in accordance with the terms of the original Participation Agreement." (Rec. #28, Exhibit 3; also A-53).

In the 1967 report to investors (Rec. #32, Exh. 1967), Associates is referred to as "A Partnership" (id. p.1 and Note 5 at id. p.5). It says:

"The management of the property and administration of the affairs of Times Square Associates are conducted from formerly vacant space in the Partnership's building without rental charge, where the General Partner also conducts certain of his own activities." (Also quoted at A-59 to 60).

Similarly Note 6 refers to "This Partnership's share of the cost..."

Similarly as to the 1968 Report to Investors (Rec. #32, Exh. 1968). Similarly, the 1969 Report to Investors, Note 5 states:

> "The partnership is not subject to federal, state or city taxes on income. However, each participant must personally report to the respective taxing authorities his proportionate share of taxable income." (Rec. #32, Exh. 1969 fourth page)

Associates filed U.S. Partnership Income Tax Returns, forms 1065, for at least the years 1966 through 1968 (Rec. #9, Exhs. 3, 4 and 5).

Even the defendants' counsel, in their memorandum in support of their motion for reargument of the summary judgment said:

> "It likewise remains clear that Sands as 'General Partner' was likewise not obligated to expend his own services..." (Rec. #38, p.23).

And on p. 16 of the same memorandum, defendants' counsel said:

> "After Sands was left as sole remaining partner in TSA [Associates]..."

Perhaps most significant is the position taken in various other litigations. In the State Court action against the Beckermans, paragraph 2 of the verified complaint reads:

> "Plaintiff TIMES SQUARE ASSOCIATES (herinafter 'ASSOCIATES') is a partnership duly organized and existing pursuant to the laws of the State of New York and conducting its business in the City and State of New York. Plaintiff SANDS is a Managing Agent of plaintiff ASSOCIATES." (Rec. #28, Exh. 7).

Finally, this Court can take judicial notice that in an action brought in the United States District Court for the Southern District of New York and entitled:

TIMES SQUARE ASSOCIATES
and IRA JAY SANDS,

Plaintiffs, 72 Civ. 3515

-against-

NEW YORK TIMES COMPANY, et al.,

Defendants.

paragraph 3 of the complaint reads:

> "Plaintiff TIMES SQUARE ASSOCIATES is, and throughout the times hereinafter alleged was, a partnership organized and existing under the laws of the State of New York and engaged in the business of owning real estate properties and placing classified advertisements with respect to those properties with or through Defendant."

It should be noted that in the action against the Beckermans, Associates was represented by the law firm of Royall, Koegel & Wells, and that in the action against the New York Times company, Associates was represented by the firm of Demov, Morris, Levin & Shein. Both of those firms are highly reputable, responsible and competent, and undoubtedly knew what they were doing when they drafted the complaints. In addition, as is well known to this Court, Sands is an experienced practicing attorney and, presumably, when he referred to Associates as a partnership and to himself as a partner thereof, he knew what he was saying. In light

of the foregoing, Sands cannot now in good faith assert that Associates was not a partnership at the time of the wrongs complained of in this action.

Of course, the mere admission by Sands that Associates is a partnership does not make it so and, thus, an analysis of the law of partnerships is in order. Subdivision 1 of section 10 of the New York Partnership Law provides:

> "A partnership is an association of two or more persons to carry on as co-owners a business for profit."

And subdivision 4 of section 11 of the Partnership Law provides in part:

> "The receipt by a person of a share of profits of a business is prima facie evidence that he is a partner in the business..."

In the instant case, Associates meets the requirements of these definitions. The investors invested $562,500 to purchase the long-term net lease and to provide Associates with the initial working capital and Sands, Wishner and Gewanter contributed their labor and skill in the management of the business. (5)

(5) That only some of the partners were to manage the business while the others would remain passive, although general partners, does not detract from the existence of the relationship of partners. The partnership in Pawgan v. Silverstein (265 F.Supp. 898, S.D.N.Y. 1967) was similar in that it had three managing partners while the remaining ones were merely passive investors. Another analysis of the Silverstein partnership is found in U.S. v. Silverstein (237 F.Supp. 446, S.D.N.Y. 1965, aff'd. 344 F.2d 1016, 2nd Cir. 1965.)

In Mitler v. Friedeberg (32 Misc.2d 78, 81-82 [1961]) the Court said:

> "...an indispensable essential of a contract of partnership or joint venture, both under common law and statutory law, 'is a mutual promise or undertaking of the parties to share in the profits of the business, and submit to the burden of making good the losses' (Reynolds v. Searle, 186 App.Div. 202, 203). 'The ultimate inquiry is whether the parties have so joined their property, interests, skills and risks that for the purpose of the particular adventure their respective contributions have become as one and the comingled property and interests of the parties have thereby been made subject to each of the associates on the trust and inducement that each would act for their joint benefit!."

Associates meets this requirement. Paragraph 5 of the Participation Agreement reads in part: (A-13)

> "Profits or losses of Associates, will be shared proportionately by all Participants, including the Sponsors [Sands, Wishner and Gewanter]. Losses, if any, will be borne by all Participants and the Sponsors, pro-rata in accordance with their respective investment..."

While Sands has from time to time referred to Associates as presently constituted as a partnership (see supra) and his counsel referred to it as a joint venture (Rec. #13, p. 13), he also said, in his original affidavit on the first motion to dismiss the complaint (Rec. #6, p. 3, par. 5):

> "Nor is this a derivative case. Five years after the organization of the syndicate and in 1966, my two partners resigned their interests and I became the sole owner of the leasehold. The investors were entitled to participate in any profits or, in the event of dissolution, in the capital held in my name. I was an agent but that is all. There was no partnership, there was no trust. There was consequently no entity. Times Square Associates, which was unincorporated, was used as a trade name for the partnership so as to designate the particular real estate syndicate. 'Times Square Associates', if it is anything now, is a trade name for my carrying on the business of the ownership of the leasehold of the building at 701 Seventh Avenue." [Emphasis added.]

Even if Sands individually owns the leasehold, it does not detract from the existence of the partnership. In Moore v. Huntington (7 Hun. 425 [1876]) the Court said:

> "A partnership in profits may exist without including title to the stock out of which such profits arise, if such be the agreement of the partners."

* * *

In originally holding that Associates is not a partnership, Judge Lasker relied upon five factors (A-35 to A-36). Before discussing these factors, however, it will be useful to set forth some general principles applicable to all the provisions of the Partnership Law. In keeping with the rule that courts are not bound by labels, it has been held that the provisions in a contract that the relationship is not one of partnership, does not

bind the court in determining the true relationship of the parties. In Madison Pictures, Inc. v. Pictorial Films, Inc. (6 Misc.2d 302, 315 [1956]) the parties referred to themselves as "buyer" and "seller" but the Court found their true relationship to be that of partners. See also Martin v. Payton (246 N.Y. 213, 218 [1927]). Partners may include any provisions that they desire in their partnership agreement and, so long as it is not against public policy, it is binding as between themselves (Lanier v. Bowdoin, 282 N.Y. 32 [1939]), (Napoli v. Domnitch, supra). When there is ambiguity as to the meaning of terms in a contract, it is to be resolved against the party who prepared the agreement (Rentways, Inc. v. O'Neill Milk and Cream Co., 308 N.Y. 342, 348 [1955]). Against these principles, we can examine the factors considered by Judge Lasker.

First, he considered it noteworthy that the agreements are not designated as partnership agreements and at no time refer to the participants as partners and that the documents refer to the interest of the participants as "securities." It should be noted, however, that the names given to the parties do not establish the nature of the relationship (Madison Pictures, Inc. v. Pictorial Films, Inc., supra) and in the instant case were probably used to distinguish the participation agreement from the one between Sands, Wishner and Gewanter

themselves. Similarly, that the investors were called "participants" was merely to distinguish them as a group from Sands, Wishner and Gewanter who were the managing partners or sponsors. Finally, that the interests of the investors was a "security" does not prohibit the relationship from being that of a partnership (Pawgan v. Silverstein, supra).

Second, Judge Lasker considered it a factor that if a participant died his interest passed to his heirs with the consent of the "Agent" with whom he contracted and that an investor could transfer his interest with the consent of that Agent. However, Judge Lasker did not distinguish between the devolution or transfer of a partnership interest, which never requires consent, and the transferee becoming a substituted partner, which cannot occur without the consent of the other partners (Partnership Law, section 40, subdivision 7). It is a feature common to most real estate syndicate partnerships that such consent be given only by the managing partners because, in a practical sense, it would be inconvenient to secure the actual consent of several hundred persons. In U.S. v. Silverstein (supra) the partnership with only seventeen non-managing partners had an identical provision.

Third, Judge Lasker considered it significant that only Sands, Wishner and Gewanter, but not the

investors, were authorized to act for Associates. While the right of co-management is given to all partners by Partnership Law, section 40, subdivision 5, the opening sentence of section 40 provides that the rules therein are subject to any agreement between the parties. Again, Pawgan v. Silverstein, supra, a general partnership, is identical in this respect.

Fourth, Judge Lasker relied on the fact that each participant entered into a separate agreement with Sands, Wishner or Gewanter, which separate agreements purported to bind only the managing partner who signed it but not the others. In point of fact, that is incorrect. Paragraph 13 of the agreement (A-15) provides that all of the executed counterparts are to be taken together to constitute on original agreement. Further, the third WHEREAS clause (A-11) provides that "said Partnership has designated Ira Sands, Jerome Wishner and George Gewanter to act as Nominee for all of the partners, and to thereby each distribute to the Participants therein, their undivided one-third interest to the entire partnership asset." This is in accordance with Partnership Law, section 20, subdivision 1, which makes each partner an agent of the partnership. Thus, by Jerome Wishner signing the agreement with the plaintiffs herein (A-15), the terms thereof became binding upon Sands.

Finally, Judge Lasker said that although the agreements provide they are to be construed in accordance with the laws of the State of New York, they do not refer to the Partnership Law. Aside from anything else, this is erroneous as a matter of grammatical construction since the general term "laws of the State of New York," includes the specific Partnership Law.

In defense of Judge Lasker's analysis it should be noted that it was made in his Memorandum of October 11, 1973 which denied the defendants' first motion to dismiss under F.R.C.P. 12. That was before the plaintiffs' motion for interlocutory summary judgment at which additional facts were presented and, as noted above, in ruling on the latter motion in June, 1974, Judge Lasker did speak of Associates as a partnership and the investors as partners. He recognized that when Sands sent letters and reports in which he referred to himself as the general partner and to Associates as a partnership, the only other partners being the investors since Wishner and Gewanter had already retired. Even if Associates was, prior to 1966, a partnership of only Sands, Wishner and Gewanter, the investors were each a sub-partner of one of the three of them by virtue of the participation agreement (<u>Silberfield</u> v. <u>Swiss Bank Corp.</u> 99 N.Y.S.2d 888 [1950] aff'd. 278 App.Div. 676). However, when Wishner and Gewanter retired in 1966 and, pursuant to paragraph [31](h) of the Agreement (A-13), Sands became the

s~le remaining Agent, he stepped into their shoes and the three sub-partnerships merged into a single partnership.

b. While, as has been demonstrated, Associates is a partnership, it may also be considered to be a trust. In Matter of Leverich (135 Misc. 774 788 [1929]) Surrogate Wingate said:

> "Some question has been raised by some of the parties as to whether the agreement as a whole does not constitute Leverich and Wohlers joint venturers. Even if it were to be held that it does, this would have no necessary bearing upon the questions involved, since it is primary that a valid trust may be contained in any sort of a document, including letters, memoranda or writings of a most informal nature..."

More recently, it was held that a real estate syndicate, identical in form to Associates, was a trust (Brotman v. Meyers, 41 A.D.2d 547 [1973]).

In Matter of Leverich (supra) Surrogate Wingate set forth the elements of a trust at length (id. pp. 785-789). These are "(1) a settlor; (2) a trustee; (3) a beneficiary; (4) a trust res; and (5) a declaration of the terms of the disposition of the trust res." (id. p. 786) Applying these elements to the instant case, we have the investors being settlors and beneficiaries; Sands, Wishner and Gewanter, or the survivors of them, as trustees; the monies paid by the investors and the leasehold purchased therewith being the

res;and the participation agreement being the declaration of the terms of the trust. Thus, Associates was at all times an express trust.

Additionally, even if each of the steps in the changing relationship be considered as something other than an express trust, Associates must now be considered as a constructive trust. If the three sub-partnerships were not merged into a single one when Wishner and Gewanter retired in 1966 Sands, by continuing as a sole "Agent" for all the participants, became a constructive trustee, even if he were the sole owner of the leasehold.

2. The Investors Own the Leasehold as Tenants in Common.

The language of the Participation Agreement also permits Associates to be viewed as merely a trade name for a business being conducted by the investors and Sands as tenants in common. The first WHEREAS clause says that Associates "owns the leasehold." The second WHEREAS clause says that Associates is a partnership consisting of Sands, Wishner and Gewanter. The third one says that said partnership has designated Sands, Wishner and Gewanter "to act as Nominee for all of the partners, and to thereby each distribute to the Participants herein their undivided one-third interest to the entire partnership asset" (the leasehold). And the fourth clause says that "the Agent and the Participants desire to establish the ownership of the leasehold, and to

define their rights and obligations with respect thereto." Thus, Associates, acting through Sands, Wishner and Gewanter as nominees, distributed the ownership of the leasehold to the investors who, as a matter of law, own the leasehold as tenants in common.

Since the participants own the leasehold in common their claims may be aggregated for meeting the the jurisdictional requirements (Snyder v. Harris, supra). Their claims are not several and this class action is not a spurious one designed to overcome the practical hurdles absent a permissive joinder. This being an action calling for equitable relief (appointment of a receiver and/or dissolution of Associates), all tenants in common are indispensable parties (Switzer Brothers, Inc. v. Byrne, 242 F.2d 909, 6th Cir. 1957).

POINT II

THE AMOUNT IN CONTROVERSY AS TO THE PLAINTIFFS AND EACH MEMBER OF THE CLASS EXCEEDS $10,000

Several items should be noted preliminarily. First, since Associates is comprised of approximately 150 investors Judge Lasker and the parties viewed the amount of $1,500,000 as necessary to be in controversy in order to meet the jurisdictional requirement (150 investors at $10,000 each). This was a shorthand way of approaching the problem.

Second, there has been no pre-trial discovery nor any examination of the books and records of Associates or F.S. Management. The amount of damages alleged in the amended complaint was based almost exclusively upon admissions made by Sands in the annual reports which he sent to the investors. In any event, the Court below should have permitted discovery to determine whether the amount in controversy requirement has been met (Goldstein v. Compudyne Corp., 262 F.Supp. 524, S.D.N.Y. 1966; Blair Holdings Corp. v. Rubinstein, 159 F.Supp. 14, S.D.N.Y. 1954; Anderson v. B.O.A.C., 149 F.Supp. 68, S.D.N.Y. 1956).

Against this background, we can turn to an analysis of the amended complaint.

* * *

The first count seeks compensatory damages of at least $326,000.(6) In keeping with the rule that jurisdiction is determined at the time suit is commenced, Judge Lasker considered only $224,662 (A-95). While we agree with the general statement of the rule, we disagree as to its application in this case. When future liability is presently being litigated the amount of that future liability is part of the amount in controversy (Thompson v. Thompson, 226 U.S. 551 [1913]). In the instant case,

(6) The calculation, taken primarily from defendants' admissions, is shown on Rec. #42, p.3. That is the minimum amount and may prove to be substantially larger after the plaintiffs have completed discovery proceedings.

the record discloses that after the action was started the defendants continued the same course of conduct complained of in the complaint and the judgment, if recovered, will require defendants to account for and repay the amounts diverted during the period subsequent to the commencement of the action. In addition, since the Court can allow amended or supplemental pleadings (F.R.C.P. 15), jurisdiction is tested in the light of such pleading (Grady v. Irvine, 254 F.2d 224,4th Cir. 1950). However, even if we accept the amount considered by Judge Lasker, we start with a known claim of approximately $225,000, ascertained from defendants' admissions but before discovery proceedings.

The fifth cause of action, properly considered by Judge Lasker to be an adjunct to the first cause of action, seeks treble punitive damages of $1,075,000.(7) However, Judge Lasker held that punitive damages were not recoverable. He did so on two basis (a) that New York courts would not award punitive damages in this type of case, and (b) that the malicious lawsuits alleged in the fifth cause of action were directed solely against the Beckermans and Mrs. Manheim, but not against the other investors (A-96 to A-97). As to the question of New York law, it should be noted that in his original decision

(7) Assuming Judge Lasker's figure of $225,000 for compensatory damages, the punitive damages would be $675,000.

in October, 1973, denying the defendants' motion to dismiss, Judge Lasker said:

> "Taking the question of punitive damages first, we note that punitive damages may provide the basis for jurisdiction unless 'it is apparent to a legal certainty from the complaint that [plaintiffs] could not recover... sufficient punitive damages to make up the requisite [amount].' Bell v. Preferred Life Assurance Society, 320 U.S. 238, 240 (1943). In the leading case of Walker v. Sheldon, 10 N.Y. 2d 401, 233 [sic, should read 223] N.Y.S. 2d 488 (1961), the New York Court of Appeals stated that 'there may be a recovery of expemplary damages in fraud and deceit actions where the fraud, aimed at the public generally, is gross and involves high moral culpability.' Id. at 405, 223 N.Y.S. 2d at 491. Expressing no view on the merits, but taking, as we must on this motion, the allegations of the complaint as true, we cannot say that it would be impossible for the Beckermans to satisfy the requirements of the New York rule and to recover punitive damages. There is no doubt that the New York standard is an extremely high one, making it difficult indeed for plaintiffs to recover punitive damages in this state. On the other hand, the federal standard for dismissal is also very high, and on the balance here we believe that it precludes dismissing the action." (A-39).

For Judge Lasker to now hold, without the benefit of testimony as to intent, motivation, etc., that punitive damages are not recoverable as a matter of law was clearly erroneous. In so holding, he felt that the first and fifth counts of the amended complaint allege merely (1) breach of fiduciary duty; (2) use by Sands of Associates' property

for his own benefit; and (3) failure to disclose (A-97). But Sands' activities went further. He deliberately attempted to hide his activities and brought specious lawsuits in an attempt to intimidate the investors into aborting an inquiry into his activities. This certainly is moral turpitude. In Walker v. Sheldon (10 N.Y.2d 401 [1961]) the most often cited authority on punitive damages in New York, the Court of Appeals said:

> "Punitive or exemplary damages have been allowed in cases when the wrong complained of is morally culpable, or is activated by evil and reprehensible motives, not only to punish the defendant but to deter him, as well as others who might otherwise be so prompted, from indulging in similar conduct in the future... (id. p.404).
>
> "Although they have been refused in the 'ordinary' fraud and deceit case [citation omitted], we are persuaded that, on the basis of analogy, reason and principle, there may be a recovery of exemplary damages in fraud and deceit actions where the fraud, aimed at the public generally, is gross and involves high moral culpability. And this court has - in line with what appears to be the weight of authority [citations omitted] - sanctioned an award of such damages in a fraud and deceit case where the defendant's conduct evinced a high degree of moral turpitude and demonstrated such wanton dishonesty as to imply a criminal indifference to civil obligations... These exemplary damages, the court declared [in Kujek v. Goldman, 150 N.Y. 176], were left to the jury 'in their sound discretion*** to amplify the damages [actually caused] by way of punishment and example' (p.180)." (id. p.405).

Walker v. Sheldon said that in ordinary fraud and deceit cases the actions of the defendant must be directed at the public generally. But what is an "ordinary" fraud and deceit case? Judge Lasker called this case "a 'garden-variety' action for breach of duty" (A-96). However, breach of fiduciary duty is not fraud and deceit. Also, the New York courts have been very liberal in construing the phrase "the public generally" to the point of disregarding it. In the Walker case, which refused to strike the allegations as to punitive damages, the complaint alleged that the individual defendants made false representations in the course of their business, although the particular representations were made only to that plaintiff. Rupert v. Sellers (48 A.D.2d 265 [1975] was an action for libel, slander and unfair competition. In Soucy v. Greyhound Corp. (27 A.D.2d 112 [1967]) the court held that punitive damages could be properly pleaded in a personal injury automobile accident case and awarded if the allegations were proven. I.H.P. Corp. v. 210 Central Park South Corp. (12 N.Y.2d 329 [1963]), which affirmed an award of punitive damages was an equity action by a tenant to enjoin the landlord from harassment by the latter which was aimed at forcing the tenant to surrender its lease. The New York Court of Appeals there cited Walker for the proposition that

"the propriety of exemplary damages as a matter of substantive law is not contested by defendants if the finding of malice was proper" (12 N.Y.2d at 333). In Veeco Instruments Inc. v. Canido (70 Misc.2d 333 [1972]) an employer was awarded compensatory damages against a former employee who, when discharged, took important computer programs with him. Further citations would only gild the lily but we should direct the Court's attention to Berkovitz v. Hanley (40 A.D.2d 921 [1972]) which is a partnership case. In Berkovitz, one partner diverted partnership funds to use as his contribution to a separate investment. The action was for breach of fiduciary duty and to impress a trust. While affirming a denial of punitive damages, the Appellate Division said that such denial was "discretionary with the trial court" [emphasis added] -- not required as a matter of law.

As to Judge Lasker's second basis for disregarding the claim for punitive damages, i.e., that Sands' actions were directed only against the Beckermans and Mrs. Manheim. Judge Lasker apparently overlooked the fact that the specious lawsuits against those people were meant to be an example for all the investors. What Sands said, in effect, was "See what happened to the Beckermans and Manheim. The same thing will happen to you if you don't stop bothering me." Even if the specious lawsuits were not aimed at

intimidating the investors, the actual defalcations and breaches of trust give rise to a claim for punitive damages by all the investors. This, for the reasons set forth above.

As to the amount of punitive damages which may be awarded, New York does not apply any percentage limitation or other formula. The amount is left to the jury whose verdict may not be set aside unless it is flagrantly extravagant. In Leombruno v. Julian (37 N.Y.S.2d 618, 623 [1942]) the Court said in a lengthy reasoned opinion:

> "It has been urged here that where punitive damages are included in the verdict, there should be a definite relationship between the amount of punitive damages and the actual damages. I can find no such rule applicable in this state. I think the rule is still as set out in Coleman v. Southwick, supra, [9 Johns. 45, 52] so many years ago."

While the reported opinion does not disclose the amount of the compensatory damages it merely discloses that in that assault and battery case the plaintiff sustained injuries and incurred medical expenses and lost wages of $140. The trial court refused to disturb the jury's verdict of $5,000 for punitive damages. On appeal, the Appellate Division, without opinion and over a two judge dissent, reduced the punitive damages to $2,500 in a short memorandum opinion (264 App.Div. 981 [1942]) which

which in no way discussed the applicable law or disagreed with the reasoning of the trial judge.

Punitive damages may be awarded even when the compensatory damages are nominal. In Buteau v. Maegeli (124 Misc. 470 [1923]), a suit for allienation of affection, the jury awarded $1 for compensatory damages and $5,000 for punitive damages. The Appellate Division, again without opinion, reduced the punitive damages to $1,218.76 (216 App.Div. 833 [1926]). In Prince v. Brooklyn Daily Eagle (16 Misc. 186 [1896]) the Court held that the mere fact that the actual damage is only six cents does not necessarily take away the plaintiffs right to punitive damages. While Buteau and Prince are old cases, they were cited with approval in the Goines v. Pennsylvania R.R. Co. (208 Misc. 103 [1955]), reversed on other grounds 3 A.D.2d 307 [1957] and the Prince case was followed as recently as 1969 in Kent v. City of Buffalo (61 Misc.2d 142 [1969] aff'd. 36 A.D.2d 85).

Thus, even if the punitive damages are seven times the actual damages at the time suit started, as calculated by Judge Lasker to be $224,662 (A-95) without the benefit of discovery, that is immaterial since the amount of punitive damages cannot be fixed until after a trial.

* * *

The second count in the amended complaint seeks $1,156,000, which is the alleged value of Associates' assets belonging to all the investors as a class. The theory of this cause of action is that since the fiduciary breached his duty the cestuis are entitled, in the discretion of the Court, to terminate their relationship and receive the value of the res. This rule applies regardless of the legal pigeon hole into which the relationship fits. It applies between principal and agent (Jewett v. Commonwealth Bond Corp., 241 App.Div. 131 [1934]):

> "However, even were the relationship between the parties to be deemed that of principal and agent based on a contract in which the defendant had acquired an interest which could not ordinarily be interfered with by this court, in so far as the non-objecting depositors are concerned, nevertheless, an agent is in a highly fiduciary relationship to the principal and can always be asked to account for its acts. A court of equity will determine the measure of relief from the situation adduced at the trial. If the fiduciary is shown to have been unfaithful to its duties, the court has full power to remove it for the protection of all the cestuis. (Randall v. Peerless Motor Car Co., 212 Mass. 352, 375; Mechem, [Law of Agency [2d ed.]] §607.)" (id. 134)

The rule of removal also applies in the case of a partnership. Partnership Law, §63 provides that a court shall decree a dissolution whenever

> "(c) A partner has been guilty of such conduct as tends to affect prejudicially the carrying on of the business,

"(d) A partner wilfully or persistently commits a breach of the partnership agreement, or otherwise so conducts himself in matters relating to the partnership business that it is not reasonably practicable to carry on the business in partnership with him,

(f) Other circumstances render a dissolution equitable.

See also Cahill v. Haff (248 N.Y. 377, 382 [1928]) where the Court said: "Or the Court may decree a dissolution where one partner has wilfully and persistently breached the partnership agreement." In the instant case, the actions of Sands clearly fall within the circumstance of at least paragraph "d". He has continually, since assuming sole management of Associates, breached the agreement by diverting monies and using the property for his own purposes without the payment of rent to Associates. While Sands can argue that he did not know he was breaching the agreement (8) he did commit other acts which, as a lawyer, he must have known were improper. He received a legal fee for representing another party to a transaction in which Associates was involved (A-65). (9) Also, Associates

(8) In opposition to the plaintiffs' motion for interlocutory summary judgment Sands argued that what he did was permitted by the agreement (Rec. #31, pp.17 et seq.).

(9) Plaintiffs have not yet conducted discovery and, consequently, do not know whether Sands also received a legal fee from Associates in connection with that transaction.

paid Sands' partner, James Geller, a $1,000 legal fee to start the Supreme Court action against the Beckermans and Sands received back $650 of that amount (A-65; Rec. #28 at page 12 of affidavit and Exh. 8 thereto). Also, Sands did not make full disclosure of all the facts to the investors and attempted to prevent them from inquiring into the affairs of Associates. Whether the Court should order a dissolution of Associates is within its sound discretion to be exercised after a trial at which all the evidence will be produced and evaluated. However, for jurisdictional purposes, the entire value of Associates is part of the amount in controversy since this is what the plaintiffs and the members of the class are seeking to recover.

It does not require citation of authority to support the assertion that when a partnership has been dissolved the partners are entitled to receive their respective share of the assets after the business has been wound up and creditors paid. The complaint alleges the value of their interests to be $1,156,000.

The same rule applies with respect to a trust. While the above quotation from Jewett v. Commonwealth Bond Corp. spoke of an agency relationship, the Court made its remarks to the defendant's assertion that the relationship was that of principal-agent and not that of

trustee-cestui. However, the Court there held that a trust relationship existed; that the defendant breached its duty; that the res be returned to the plaintiffs; and that a new trustee appointed. Even if the trustee is removed and the res continues in trust (In re Wohl's Est., 36 N.Y.S.2d 926 [1942]; Gould v. Gould, 203 App. Div. 807 [1922]) the value of the beneficiary's interest, aside from the question of aggregation, is deemed the amount in controversy. See generally 1 Moore's Federal Practice, par. 0.95.

Judge Lasker dealt with the second count of the amended complaint at A-98. He held that "Whether Count II is viewed as the jurisdictional bootstrap for Count I, or as a separate claim for breach of contract to pay distributors, it fails to state a claim." Unfortunately, Judge Lasker misperceived Count II since it is neither of the things characterized by him. It seeks, in effect, a dissolution of Associates by reason of the wrongful acts alleged in Count I and recovery of the entire interest in Associates applicable to the investors. That the second count is not a bootstrap to the first can be illustrated as follows. Suppose plaintiffs can prove that Sands deliberately and with evil intent diverted assets of Associates but are unable to establish the amounts of such diversions. In that

event, there could be no recovery on the first count because plaintiffs would not have proven the amount of their damages; but the Court could order a dissolution of Associates as prayed in the second count because of the deliberate defalcations. As to Judge Lasker's view that the second count is for breach of contract to pay distributions, we can only say that he misread the amended complaint. The reference to the amounts of distributions in arrears (A-98) only bears on the value of the investors' interests ($1,156,000) in all the assets, and it is that value which they seek to recover by the second count.

Thus, the amount of each investor's interest in all Associates' assets is part of his own amount in controversy.

* * *

The third count seeks to impress a trust on the assets of F. S. Management into which the amounts it wrongfully received from Associates can be traced. The equitable principle of tracing which underlies the claim is stated in Section 202 of the Restatement of the Law of Trusts, Second. That section provides:

> "Following Trust Property into Its Product. (1) Where the trustee by the wrongful disposition of trust property acquires other property, the beneficiary is entitled at his option either to enforce a constructive trust of the property so acquired or to enforce an equitable lien upon it to secure his claim against the

> trustee for damages for breach of trust, so long as the product of the trust property is held by the trustee and can be traced."

The same rule applies to partnerships (Holmes v. Gilman, 138 N.Y. 369 [1893]). In Matter of Hyde (149 Misc. 291, [1933]), the Court said at page 296:

> "...'The rule of law and equity is strict and severe on such occasions. If a party having charge of the property of others, so confounds it with his own that the line of distinction cannot be traced, all the inconvenience of confussion is thrown upon the party who produces it, and it is for him to distinguish his own property or lose it. If it be a case of damages, damages are given to the utmost value that the article will bear.' (KENT, C., in Hart v. Ten Eyck, 2 Johns. Ch. 62, 108.)
>
> "When the confusion is fraudulent (and here it was part of a general scheme of fraud by accountant) the wrongdoer loses all of the value of his own goods unless he establishes which were his. (The Idaho, 93 U.S. 575, 585, 586.)
>
> "The burden of proof in such situations is wholly upon the guilty party, and if not sustained, the innocent party takes the whole..."

Thus, the investors in Associates are entitled to recover from F. S. Management the assets and properties into which the diverted funds were invested.

Plaintiffs admit that they do not know the value of these assets but, as stated earlier, there has been no discovery although it has been sought (Rec. ##40, 41 and 57). It is true that a person may not bring a lawsuit to

discover whether he has a claim. This is quite different, however, from bringing a lawsuit on a known claim which is unknown in amount. In the latter case, discovery may be had to ascertain the amount of the claim. In Blair Holdings Corp. v. Rubenstein (159 F.Sup. 14, S.D.N.Y. 1954) it was held that a party has a right to take depositions to secure information bearing on the question of jurisdiction when that issue is before the Court. This comports with the philosophy underlying disclosure with respect to F.R.C.P. 12(c), 12(d), and 56(f).

In this regard, reference is made to the Interrogatories and the Request for Production of Documents which plaintiffs had served upon the defendants (Rec. ##40, 41).

* * *

The fourth count seeks recovery of an amount authorized by Section 442-e, subdivision 3 of the New York Real Property Law on account of the management fees and leasing commissions paid to F.S. Management, an unlicensed real estate broker. The parties do not disagree as to the facts that F.S. Management is not a licensed real estate broker although Sands has been so licensed.

It is the plaintiffs' contention that the fact that Sands has been licensed does not permit F.S. Management to avoid the licensing requirements. Section 440-a provides:

"No person, co-partnership, or corporation shall engage in or follow the business or occupation of, or hold himself or itself out, or act temporarily or otherwise as a real estate broker or real estate salesman in this state without first procuring a license therefor as provided in this Article..." [emphasis added]

Section 441, subdivision 1, provides:

"Any person, co-partnership, or corporation desiring to act as a real estate broker...shall file with the Department of State at its office in Albany an application..." [emphasis added]

In rejecting the plaintiffs' contention, Judge Lasker said that "...the violation, if any, was purely technical because F.S. Management is clearly the alter ego of Sands, who is a licensed broker and whose family wholly owns F.S. Management." The conclusion that F.S. Management is Sands' "alter ego" is not supported by the record. We know that F.S. Management was organized in or about February, 1967 to take over some real estate and investment activities in which Sands was interested and that he was vice president of the corporation (Rec. #12, par. 4); we also know that Claire Schlusselberg is Sands' mother (Rec. #32, par. 7); we know that reports to Investors disclose Sands to be an officer of the corporation. But we do not know the extent, if any, of his financial interest in F.S. Management (Rec. #32, Exh. 1970, Note 6; Exh. 1971, Note 7; and Exh. 1972, Note 4). In

any event, the cases cited by Judge Lasker are clearly distinguishable. In Vin Clair v. Kall and Kall, Inc. (196 N.Y.S.2d 237 [1960]), the person seeking the commission was a licensed salesman who negotiated the transaction at a time he was employed by a licensed broker. The Court in Vin Clair quoted from J.L. Holding Co. v. Reis (240 N.Y. 424) as follows:

> "This section was intended to strengthen the general provision that after October 1, 1922, no one should act as a real estate broker without a license. Unlicensed persons were not to be allowed to shield themselves from its penalties by using the name of a qualified broker and then demanding a part of the commissions earned." (id. 427).

The dicta would clearly dispose of the defendants' contentions herein. The case of Galbreath-Ruffin Corp. v. 40th and 3rd Corp. (25 A.D.2d 114 [1966]) must be limited to its facts. There all persons were licensed. The difficulty arose when Shannon, a licensed individual broker of John W. Galbreath & Co., Inc. a licensed corporated broker, acted for a short period of time, for the plaintiff which was a licensed corporate broker related to John W. Galbreath & Co., Inc. although Shannon was not licensed as a salesman of the plaintiff. To this must be added the further fact that "the record leaves little doubt that these defendants were aware of the relationship and the individual status. Since the defendant executed the leases referred to,

they accepted the benefits. The pivotal question to be resolved is whether under the circumstances <u>here present</u> the statutory defense may be availed of as against <u>this plaintiff</u>." (id. pp. 120-121) [emphasis added]. Also, in the <u>Galbreath-Ruffin</u> case the amounts were payable to a licensed broker while in the instant case the fees were paid to F.S. Management which is not licensed.

Finally, Judge Lasker relied upon <u>Kilpatrick</u> v. <u>Rose</u> (96 N.Y.S. 2d 276 [1950]) for the proposition that under New York law, the remedy created by section 442-e(3) is an exclusive one for which the doctrine of election of remedies applies (A-102). That proposition may be true, but it does not dispose of the issue since remedies may be pleaded in the alternative and need not be consistent (F.R.C.P. 8(e)) and the election of remedies is to be made at the time the judgment is entered.

Thus, Judge Lasker erred in concluding that, as a matter of law, the amount in controversy as to the plaintiffs and each investor does not exceed $10,000. And, if he was correct, he further erred in not permitting the plaintiffs to conduct discovery to ascertain the facts to support jurisdiction.

POINT III

THE COURT BELOW ERRED IN DISMISSING THE COMPLAINT AFTER HAVING GRANTED PLAINTIFFS AN INTERLOCUTORY SUMMARY JUDGMENT, BUT BEFORE A HEARING ON THE ISSUE OF DAMAGES, WHEN THE DEFENDANTS' MOTION TO DISMISS FOR LACK OF JURISDICTION WAS DENIED ALMOST TWO YEARS PREVIOUS AND TWICE THEREAFTER BEFORE BEING FINALLY GRANTED

If the jurisdictional amount exists at the time the jurisdiction is invoked subsequent events affecting the amount in controversy cannot destroy jurisdiction. See 1 Moore's Federal Practice, par. 0.91[3]. At par. 0.92[1] (p.835) Professor Moore says:

> "It is submitted that the amount actually recovered will not retroactively affect jurisdiction where the amount set out in the complaint was asserted in good faith, otherwise, jurisdiction would have to await final determination of the merits of the controversy."

This is in keeping with the concept that the amount in controversy is what the parties are fighting about, not what the Court will ultimately award (Zunamon v. Brown, 418 F.2d 883, 8th Cir. 1969; Petroleum Transit Co. v. Copeland, 240 F.Supp.585, D.C.S.C. 1965).

In determining the issue of jurisdiction, plaintiffs' allegations of value govern in determining the amount in controversy, except where, upon the face of the complaint, it is not legally possible for him to recover the jurisdictional amount. In St. Paul Mercury

Indemnity Co. v. Red Cab Co. (303 U.S. 283 [1938]) the Court said at page 288-289:

> "The rule governing dismissal for want of jurisdiction in cases brought in the federal court is that, unless the law gives a different rule, the sums claimed by the plaintiff controls if the claim is apparently made in good faith. It must appear to a legal certainty that the claim is really less than the jurisdictional amount to justify dismissal." (Id. at 288-89) (Footnotes omitted).

The determination of the amount in controversy, then, must be made from the face of the complaint with the allegations tested only by the requirement of good faith. It has been held that a plaintiff's inability to recover the jurisdictional minimum does not show his bad faith or oust the Court's jurisdiction (Mercer v. Byrons, 200 F.2d 284, 1st Cir. 1952).

Of course, if the amended complaint changes the nature of the right being asserted the jurisdictional question must again be examined (Grady v. Irvine, supra, and the second Miller v. First National City Bank, supra). But in the case at bar the amended complaint did not change the nature of the right being asserted and, thus, Judge Lasker should not have again examined the jurisdictional question.

Further, Judge Lasker sustained the original complaint on the basis that the claim for punitive damages was, on its face, a sufficient amount in controversy to sustain jurisdiction (Rec. #16; A-39). He subsequently adhered to this conclusion when he granted the summary judgment and again when he denied the defendants' motion for reargument. Only

on the motion to dismiss the amended complaint, when he found that the then known defalcations at the time suit was commenced was only approximately $225,000 and that the punitive damages would have had to be seven times that amount in order to reach the jurisdiction minimum (10) did he conclude that there was no jurisdiction. However in so holding, not only did Judge Lasker disregard the rule that subsequent events and the subsequently discovered facts as to the amount of recovery do not destroy jurisdiction but he also overlooked the Supreme Court's decision in Bell v. Preferred Life Assur. Soc. of Montgomery, Ala. (320 U.S. 238 [1943]). There the Court held that the controversy when a jurisdictional amount was involved could not be decided on the assumption that a jury verdict for actual and punitive damages if rendered for an amount in excess of the jurisdictional minimum would be excessive and set aside. And, as state previously, Walker v. Sheldon (supra) holds that the question and amount of punitive damages are to be decided by the jury - on the trial court in a non-jury case.

Similarly, from the face of the amended complaint a Court could not find that the second count, which seeks to recover the entire value of the investors' interests in Associates, must be denied as a matter of law. It may be that after a trial the Court would not award the investors that relief but, as indicated earlier, that does not affect the amount in controversy.

(10) That calculation by Judge Lasker disregarded the amounts sought in the second, third, and fourth counts of the amended complaint. Judge Lasker further assumed that, as a matter of law, punitive damages of seven times actual damages was not permissible. As indicated previously, New York does not have such a limitation.

Without belaboring this POINT we can conclude it by saying that having found the existence of a jurisdictional amount in controversy in October, 1973, Judge Lasker could not have dismissed the amended complaint almost two years later when the fact then known, without the benefit of discovery, showed an amount less than the jurisdictional minimum. In fact, discovery may disclose that as of the commencement of this action the amount of the defalcations together with only treble punitive damages may reach the jurisdictional minimum. In any event, regardless of what is actually found, the amount that the parties are fighting about exceeds $10,000 with respect to the plaintiffs and each member of the class.

POINT IV

A DERIVATIVE ACTION MAY BE MAINTAINED IN THE RIGHT OF ASSOCIATES

It does not require extensive discussion or citation of authorities to establish that a non-managing partner in a partnership or a beneficiary of a trust may maintain a derivative action in the right of the partnership or trust (Rivera Congress Associates v. Yassky, 18 N.Y.2d 540 [1966]; Robinson v. Adams, 81 App.Div. 20 [1903]). Both Judge Lasker and the defendants recognize that to be the rule of law and, in the original motion to dismiss the complaint, addressed themselves only to the

question of whether Associates was such an entity in whose right a derivative action could be maintained. Without discussing whether Associates is a trust, Judge Lasker correctly stated that the central issue was whether Associates is a partnership (A-33).(11) As set forth previously herein, plaintiffs believe that Associates is both a partnership and a trust and the arguments in support of that contention need not be repeated here.

It is clear that if the derivative action may be maintained, as was attempted in the original complaint, the sole plaintiff with respect to the derivative claim is Associates and, clearly, its claim against each of the defendants exceeds $10,000.

CONCLUSION

For all of the foregoing reasons, it is respectfully submitted that the Court below was in error in dismissing both the amended complaint and the derivative claim in the original complaint. In a practical sense, the form that this action takes is immaterial. Whether it be a derivative action in the right of Associates or a direct action by the investors the defendants will pay the identical amount by way of compensatory and punitive damages. If it is a direct action

(11) Although Judge Lasker did not discuss whether Associates was a trust, the plaintiffs did urge that contention on that original motion to dismiss (Rec. #10, pp. 17-18).

the defendants will pay the amounts to the investors; if it is a derivative action, they will pay the amount to Associates which will in turn distribute it to the investors since it is clearly not needed in Associates' business. As to the dissolution of Associates and the distribution of its assets to the investors, the results will again be identical regardless of the form of the action. If the Court finds such relief appropriate in a direct action the Court will either order the property sold and the proceeds distributed to the investors or it will direct Sands to pay the investors the fair value of the property (which theoretically would be the same), as prayed in the second count of the amended complaint. If the action be a derivative one and if the Court deems it appropriate the Court will order the identical relief. If removal of Sands and a dissolution of Associates is not deemed appropriate, the Court will deny that relief regardless of the form of the action.

One further item should be mentioned at this juncture. If this Court rejects all of the plaintiffs' contentions and affirms the judgment below, the plaintiffs' request that such affirmance be without costs. This Court's authority to deny costs to a successful party is set forth in Rule 39 of the Federal Rules of

Appellate Procedure. See also 9 Moores Federal Practice Par. 239.02, particularly footnote 2 thereto. It should be noted that Judge Lasker ordered that the complaint be dismissed without costs (A-103) and that the judgment of dismissal so provides (Rec. #60). Presumably, Judge Lasker denied costs because he recognized the injustice of awarding costs to the defendants who, it is clear, committed breaches of fiduciary duty and that the awarding of costs would thereby doubly penalize the innocent investors. It is requested that this Court follow Judge Lasker's lead in that regard.

Respectfully submitted,

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